SIRC of ICAI

Bank Branch Audit
IRAC norms

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Session Coverage

1. 1. COVID-19- Regulatory Package
2. 2. Concessions to MSME Sector
3. 3. Resolution of stressed assets
4. 4. Prudential Norms (Quick Refresher)
5. a. NPA norms
6. b. Restructuring of advances & project loans
7. c. Asset Classification
8. d. Provisioning norms

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COVID-19-Regulatory Package

RBI issued a Circular DOR.No.BP.BC.47/21.04.048 /2019-20 dated March 27, 2020.

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COVID-19-Regulatory Package

RBI issued a Circular DOR.No.BP.BC.47/21.04.048 /2019-20 dated March 27, 2020.

This circular deals with the following:

1. Rescheduling of Payments – Term Loans and Working Capital Facilities.

2. Easing of Working Capital Financing.

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Rescheduling of Payments - Term Loan

Banks, FIs & NBFCs are permitted to grant a moratorium of 3 months for all term loans (including agricultural term loans, retail and crop loans) on payment of all instalments falling due between March 01, 2020 & May 31,2020.

Instalments will include the following (i) principal and/ or interest components; (ii) bullet repayments; (iii) Equated Monthly instalments; (iv) credit card dues.

Interest shall continue to accrue on the outstanding portion of the term loans during the moratorium period.

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Rescheduling of Payments – Working capital facility

In respect of working capital facilities sanctioned in the form of cash credit/overdraft ("CC/OD"), lending institutions are permitted to defer the recovery of interest applied in respect of all such facilities during the period from March 1, 2020 upto May 31, 2020 ("deferment").

The accumulated accrued interest shall be recovered immediately after the completion of this period.

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Easing of Working capital facilities

In the case of borrowers enjoying CC/OD facilities, the banks are permitted to recalculate the 'drawing power' by reducing the margins and/or by reassess-sing the working capital cycle. This relief is available for all changes effected upto May 30, 2020.

The banks **should satisfy themselves that the account is stressed due to the economic fall out caused by the pandemic.**

Accounts provided the above relief will be subject to supervisory review for justification.

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Asset downgrade & credit rating

As the moratorium/deferment/recalculation of the 'drawing power' is being provided specifically to tide over economic fallout from COVID-19, the same will not be treated as concession or change in terms and conditions of loan agreements and by itself shall not result in asset classification downgrade. (In other words this relief will **Not** amount to Restructuring).

Credit Information Companies shall ensure that the actions taken by lending institutions pursuant to the above announcements do not adversely impact the credit history of the beneficiaries.

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Recent Developments

Concessions to MSME sector

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MSME Sector

1) Circular DBR.No.BP.BC.100/21.04.048/2017-18 dated February 07, 2018
2) Circular DBR.No.BP.BC.108/21.04.048/2017-18 dated June 6, 2018
3) Circular DBR.No.BP.BC.18/21.04.048/2018-19 dated Jan 1, 2019
4) Circular DOR.No.BP.BC.34/21.04.048/2019-20 dated February 11, 2020
5) Circular FIDD.CO.MSME.BC.No.14/ 06.02.031/ 2018-19 dated February 21, 2019

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One-time restructuring of existing loans to MSMEs (Circular dt Jan 01, 2019 & Feb 11,2020)

- There must be a Board approved policy.
- A 'Standard' loan to MSME may be restructured without downgrade in AC.
- One time exercise.
- Specified Conditions must be complied with to enjoy the special dispensation.
- A 'NPA' loan to MSME can also be restructured, but it will have to be downgraded as per extant AC norms.

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One-time restructuring of existing loans to MSMEs

Specified conditions

- The aggregate exposure (FB+NFB) of banks & NBFCs should not exceed 250 million as on Jan 01, 2019 / Jan 01, 2020
- The entity should be registered with GST or be exempt from GST.
- The borrower account is in default but is a 'standard asset' as on Jan 01, 2019 /Jan 01,2020 and continues to be classified as such till the date of implementation of the restructuring.
- The restructuring is implemented before Mar 31, 2020/Dec 2020

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When is implementation complete?

- All related documentation, including execution of necessary agreements between lenders and borrower / creation of security charge / perfection of securities are completed by all lenders; and

- the new capital structure and / or changes in the terms and conditions of the existing loans get duly reflected in the books of all the lenders and the borrower.

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One-time restructuring of existing loans to MSMEs Provisioning Requirements

- An additional provision of 5% shall be made in respect of the restructured accounts.
- Bank may reverse the provision at the end of the specified period, subject to the account demonstrating satisfactory performance during the specified period.
- ***Income recognition shall be as if no benefit is provided i.e. interest shall not be recognized on accrual basis if overdue for more than 90 days.***

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CHECK LIST for MSME concessions

- Udyog Aadhar certificate or registration certificate from state/ central govt evidencing that that the borrower is an MSME unit.
- Evidence for Aggregate exposure – CA certificate
- GST Regn. certificate/check if it is alive on relevant date
- Check whether the account was standard on the relevant date.
- Check whether there were overdues as on relevant date.
- Evidence for confirmation of implementation - Eg. – Certificate from CA for capital structure as per the books of the borrower, confirmation from other lenders that implementation is complete in their books and all documents have been executed.

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Prudential Framework for Resolution of Stressed Assets

- RBI has announced a revised framework for resolution of stressed assets on June 07, 2019. (RBI/2018-19/203 DBR.No.BP.BC 45/21.04.048/2018-19

Framework aims at strengthening the structure by:

1) Early identification and reporting of stress
2) Implementation of resolution plan for defaulting accounts, supported by independent credit evaluation by credit rating agencies.
3) Implementation conditions have been prescribed.
4) Enable banks to take timely action for resolution of stressed accounts & provides for adequate disclosures by banks
5) Additional provision if RP not implemented within prescribed timelines.
6) Envisages higher provisioning, penal action & direction to file under IBC on banks in case of concealing of information.

- The revised framework has discontinued with immediate effect Framework for Revitalising Distressed Assets, CDR, Flexible Structuring of Existing Long Term Project Loans, SDR, Change in Ownership outside SDR, and Scheme for Sustainable Structuring of Stressed Assets. Joint Lenders' Forum (JLF) as mandatory institutional mechanism for resolution of stressed accounts also stands discontinued

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Prudential Framework for Resolution of Stressed Assets

Lenders shall identify incipient stress in loan accounts, immediately on default, by classifying stressed assets as special mention accounts (SMA) as following:

SMA sub-categories	Basis for classification – principal or interest payment or any other amount wholly or partly overdue between	For revolving credit facilities Basis for classification – Outstanding balance remains continuously in excess of the sanctioned limit or drawing power, whichever is lower, for a period of:
SMA-0	1–30 days	-
SMA-1	31–60 days	31-60 days
SMA-2	61–90 days	61-90 days

Default

Non-payment of debt when whole or any part or instalment of debt amount has become due and payable and is not repaid by debtor.

For revolving facilities like cash credit, default would also mean, without prejudice to the above, the outstanding balance remaining continuously in excess of the sanctioned limit or drawing power, whichever is lower, for more than 30 days17

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- **Prudential Norms**
- **a**
- **Quick Refresher**

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NPA NORMS

- Uniform norm of 90 days for all advances including Government guaranteed Accounts

- Agricultural loans – Continues to be based on crop seasons

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NPA NORMS- Term Loans

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- Interest and/ or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan.

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NPA NORMS- Term Loans

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- If **arrears** of interest and principal are paid by the borrower in the case of loan accounts classified as NPAs, the account should no longer be treated as non-performing and may be classified as 'standard' accounts. (Para 4.2.5 – RBI Master circular).
- Upgradation is allowed only if the account reaches "no overdues" status. This should not be misunderstood with "overdues brought within 90 days".

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NPA NORMS- OD/CC

The account remains 'out of order' in respect of an Overdraft/Cash Credit (OD/CC).

An account should be treated as **'out of order'** where

- The balance o/s in the account remains continuously in excess of the limit/DP during a period of 90 days.
- The balance o/s is within the limit/DP, but there are no credits continuously for 90 days or the credits are inadequate to cover the interest debited during the same period.

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NPA NORMS - Bills

- A bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted.

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Agricultural Advances- NPA

- A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons.
- A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.
- “Long duration” crops would be crops with crop season longer than one year
- Crops, which are not “long duration” crops, would be treated as “short duration” crops.
- The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers’ Committee in each State.

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Agricultural Advances- Interest application

Crop Season	Kharif	Rabi
Disbursement Period	April 01 to Sept 30	Oct 01 to March 31
Interest Application	Annual	Annual
Interest Application date	31st March	30th June
Compounding	Annual	Annual
Due Date	31st March	30th June
Compounding from date	After 31st March	After 30th June
Penal Interest	If overdue, after 31st March	If overdue, after 30th June

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Crop Season- RBI clarification recd by Maharasthra SLBC

- Loan may be treated as NPA immediately on completion of two crop seasons / one crop season (as the case may be, depending on the duration of the crops) after the repayment due date.
- Two crop seasons after the due date should refer to only those two consecutive crop seasons in which the farmer usually undertakes crop production.

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RBI clarification – Crop season

The crop season for each crop, means the period up to harvesting of the crops raised. The asset classification norms assume that there is normal crop yield during the season for which credit is extended.

Hence, immediately after consecutive two harvest seasons (as per the cultivation pattern followed by the farmer borrower) from repayment due date, the account is to be identified as NPA.

In case of natural calamities as declared by the SG, the loan should be restructured/ rescheduled

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Agri loan NPA - Examples

Type	**Short Duration Crop Loan – Kharif (July –October)**	**Short Dration Crop Loan - Rabi (October – March)**
Loan Disbursed	April 15 - Sept 15	Oct 15 - Mar 16
Due Date	31-Mar-2016	30-Jun-2016
Overdue Date	01-Apr-2016	01-Jul-2016
NPA turning date	31-Mar-2018	30-Jun-2018
Remarks	After two crop season. First crop season will end at March 2017and other will end at March 2018	After two crop season. First crop season will end at June 2017 and other will end at June 2018

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Agri loan NPA - Examples

Type	**Long Duration Crop Loan (eg Sugarcane with 18 months harvesting period)**	**Short Dration Crop Loan - Rabi (October – March)**
Loan Disbursed	June 15 - July15	Oct 15 - Mar 16
Due Date	31-Mar-2017	30-Jun-2016
Overdue Date	01-Apr-2017	01-Jul-2016
NPA turning date	31-Mar-2018	30-Jun-2018
Remarks	After one crop season. First crop season will end at March 2017and other will end at March 2018	After two crop season. First crop season will end at June 2017 and other will end at June 2018

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Agricultural Advances

- Where natural calamities impair the repaying capacity of agricultural borrowers, banks may decide on their own as a relief measure conversion of the short-term production loan into a term loan or re-schedulement of the repayment period; and the sanctioning of fresh short-term loan, subject to guidelines contained in RBI circular FIDD No FSD BC.01/05.10.001/2015-16 dated July 1, 2015.

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Other Advances – spl situations

- Where natural calamities impair the repaying capacity of other borrowers, banks may decide on their own as a relief measure
- Should have the approval of SLBC
- Master Circular RPCD.No.PLFS.BC 6/05.04.02/2013-14, dated July 1, 2013

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Significant factors for classifying an account as NPA in Working capital advances

- Stock statements should not be more than 3 months old.
- Regular and ad hoc limits should not be left lapsed without renewal for a period of more than 180 days
- Solitary or very few credits in the account before the balance sheet date.

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Income Recognition

- Income is to be recognised based on recovery
- Not applicable to advances against Life Insurance Policies, NSCs, IVPs, KVPs etc, provided requisite margin is maintained.
- Critical area in respect of OD against deposits wherein Deposits with multiple Interest are taken as security
- Critical area in respect of loan against FD wherein interest is drawn periodically by the depositor but interest on loan is accumulated without payment

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Reversal of Interest

- In respect of accounts classified as NPA for the first time, interest debited in the current year (2019-20) and **previous years** which has not been realised should be reversed or provided.

- This will apply to Government guaranteed accounts also.

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Meaning of Restructured Account

- Reserve Bank of India has defined a restructured account

  as one where the bank, for economic or legal reasons relating to the borrower's financial difficulty, grants to the borrower concessions that the bank would not otherwise consider

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Meaning of Restructured Account

- Restructuring means modification of terms of the advances including alteration

  - in repayment period,(including extension of moratorium period)
  - repayment amount,
  - amount of installments,
  - rate of interest.

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Restructured Accounts- Key points

- **Specified Period** means a period of one year from the commencement of the first payment of interest or principal, **whichever is later,** on the credit facility with longest period of moratorium under the terms of restructuring package.
- Satisfactory performance during the specified period means adherence to the specified conditions during that period.

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Restructured Accounts- Key points

Satisfactory performance

Non-Agricultural Cash Credit Accounts

- In the case of non-agricultural cash credit accounts, the account should not be out of order any time during the specified period, for duration of more than 90 days and there should not be any overdues at the end of the specified period.

Non-Agricultural Term Loan Accounts

- In the case of non-agricultural term loan accounts, no payment should remain overdue for a period of more than 90 days and there should not be any overdues at the end of the specified period.

All Agricultural Accounts

- In the case of agricultural accounts, at the end of the specified period the account should be regular.

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Restructured accounts- Sacrifice

- The term **'bank's sacrifice**' means the amount of "**erosion in the fair value of the advance**".

- Reduction in the rate of interest and / or reschedulement of the repayment of principal amount, as part of the restructuring, will result in diminution in the fair value of the advance

- It is necessary for banks to measure such diminution in the fair value of the advance and make provisions for it by debit to P&L account. 39

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Project Loans

- **Project loans** is the long-term finance of infrastructure and industrial projects based upon the projected cash flows of the project rather than just the balance sheets of its sponsors.
- the '**Date of Completion'** and the '**Date of Commencement of Commercial Operations' (DCCO),** of the project should be clearly spelt out at the time of financial closure of the project and the same should be formally documented.

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Project Loans

- In several instances, the completion of the projects is delayed due to extraneous reasons beyond the control of the promoters.
- The reasons for delay include legal disputes, delay in obtaining government approvals, etc.
- In such a situation Banks may restructure / reschedule
  - Project loans for infrastructure sector
  - Project loans for non infrastructure sector

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Project Loans

Deferment of DCCO not treated as restructuring and hence asset classified as Standard

Infrastructure Projects	**Non Infrastructure Projects**	**Conditions**
The revised DCCO falls within a period of **two** years from the original DCCO stipulated at the time of financial closure	The revised DCCO falls within a period of **one** year from the original DCCO stipulated at the time of financial closure	The revised repayment period should be equal to or shorter than the original repayment term. In other words if the repayment term is extended it will amount to restructuring

Standard Asset - Provision required 0.40%

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Project Loans

Restructuring of Project loans by way of revision of DCCO for reasons beyond the control of the promoters

Infrastructure Projects	Non Infrastructure Projects	Conditions
Up to another **one** year (total extension of **three** years from the date of original DCCO).	Up to another **one** year (total extension of **two** years). **Please note that this benefit is not available to Commercial Real Estate Exposures**	1. The application for restructuring should be received before the expiry of the deferred DCCO & the account must be standard as on the date of application for restructuring 2. In case of moratorium for payment of interest, banks should not book income on accrual basis beyond two years (for infrastructure loans) & one year (for non infrastructure loans) from the date of original DCCO

Standard Asset - Provision required 5.00%

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Project Loans

Restructuring of Infrastructure Projects involving court cases

Infrastructure Projects	Conditions
Up to another **two** years (total extension of **four** years from the date of original DCCO), in case the reason for extension of DCCO is arbitration proceedings or a court case.	1. The application for restructuring should be received before the expiry of the deferred DCCO & the account must be standard as on the date of application for restructuring 2. In case of moratorium for payment of interest, banks should not book income on accrual basis beyond two years (for infrastructure loans) & one year (for non infrastructure loans) from the date of original DCCO

Standard Asset - Provision required 5.00%

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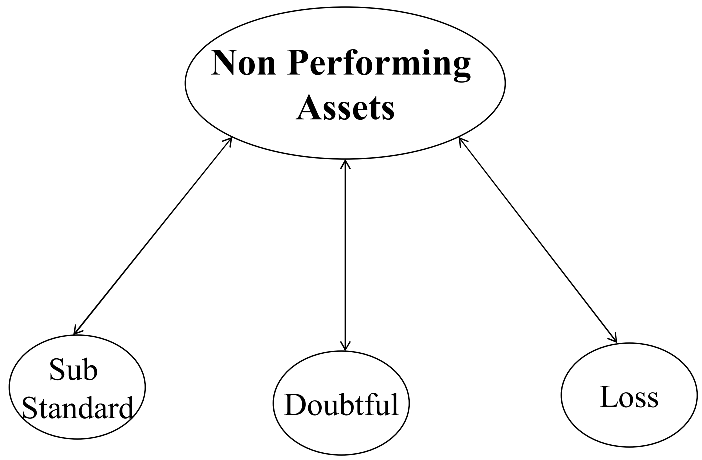

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Sub Standard Assets & Doubtful assets

- An NPA which is less than 12 months old – SSA
- An NPA which is more than 12 months old - DA
- In case erosion in value of securities is more than 50%, classify as doubtful
- Critical point – Valuation has to be done once in three years for NPAs.

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Loss Assets

- An asset considered uncollectible
- An asset where **loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly**
- An asset whose security value has been eroded by more than 90 % of the advance value

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Asset Classification

- Asset Classification to be borrower-wise and not facility-wise

Exceptions

- Bills discounted under LC until default
- Mark to market value of derivatives contract
- Additional facility granted to a restructured NPA

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Asset Classification

- Asset classification of **accounts under consortium** should be based on the record of recovery of the individual member banks
- In case of multi branch financing – The classification by the branch where main limit is availed has to be considered by all branches.
- CRITICAL – Certificate from Main branch is compulsory since the operations may be good in the branch where sublimit is availed.
- A NPA need not go through the various stages of classification in cases of serious credit impairment

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Asset Classification

- **Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs and life policies need not be treated as NPAs.**
- Advances against gold ornaments, government securities and all other securities are not covered by the above exemption
- A sub-standard accounts which has been subjected to restructuring etc., would be eligible to be upgraded to the standard category only after the specified period of one year

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Asset Classification
Govt. Guaranteed Accounts

Accounts to be classified as NPA if guaranteed by

- Central Govt. when the guarantee is repudiated.
- State Govts. When the guarantee is invoked and remains in default for more than 90 days.

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Provisioning Whose responsibility

- ***The primary responsibility for making adequate provisions for any diminution in the value of loan assets, investment or other assets is that of the bank managements and the statutory auditors.***
- ***The assessment made by the inspecting officer of the RBI is furnished to the bank to assist the bank management and the statutory auditors in taking a decision in regard to making adequate and necessary provisions in terms of prudential guidelines.***

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Provisioning Norms

Standard assets(other than Restructured accounts) – on global loan portfolio

a) Direct advances to agricultural and SME sectors	0.25%
b) Commercial Real Estate (**CRE) Exposures**	1 %
c) Commercial Real Estate – Residential Housing Sector (**CRE-RH)**	**0.75%**

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Provisioning Norms

- Standard assets (other than Restructured accounts) – on global loan portfolio
- d) Housing loans extended at teaser rates – 2%

  (***The provisioning on these assets would revert to 0.40per cent after 1 year from the date on which the rates are reset at higher rates if the accounts remain 'standard'.)***
- e) All other Standard advances – 0.40%

  Note : Provision for restructured standard advances is set out in the subsequent slide

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Provisioning Norms

- Accounts Restructured during the current year classified as standard – 5 %
- Accounts Restructured during earlier years classified as standard – To be increased to 5 %

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Provisioning Norms

- Sub standard assets - 15 percent on total outstanding should be made without making any allowance for DICGC/ECGC guarantee cover and securities available

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Substandard Assets

- In case of Substandard accounts, where security available abinitio at the time of sanction is less than 10% of both funded and non funded limits put together, then the provision to be made is 25 % **(20% in case there is an escrow account in case of infrastructure lending, infrastructure loan accounts)** of the Outstanding Value
- It is different from erosion of security to be classified as loss asset.

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Provisioning Norms

- Doubtful assets – 100 % of the unsecured portion

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25/40/100% (depending on age) of the secured portion

- Loss Asset – 100%

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PROVISIONING – 2019-2020

SI. No.	NPA Date	Status of Asset	Unsecured Portions	Secured Portion
I	Before 1.4.2016	D3 – Current year	100% of Outstanding irrespective of the availability of security as reduced by ECGC cover	

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PROVISIONING – 2019-2020

II	1.4.2016-31.3.2018	D2 – Current year	100% as reduced by ECGC Cover	40%
III	1.4.2018-31.3.2019	D1 – Current year	100% as reduced by ECGC Cover	25%
IV	1.4.2019-31.3.2020	Substandard current year	15% of the outstanding irrespective of security or ECGC Cover **	

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Master Circular Ref .

- RBI/2014-15/74 DBOD.No.BP.BC. 9 /21.04.048/2014-15 dated July 1, 2015- **Master circular for Prudential norms on IRAC and Provisioning relating to Advances**

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THANK YOU

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